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SUBJECT: 2006 REPORT ON INVESTMENT DISPUTES AND EXPROPRIATION CLAIMS
- POST INPUT

11. (SBU) This cable is Sensitive But Unclassified and contains business-sensitive information. Not for Internet distribution. Please handle accordingly.

12. (U) This cable responds to Reftel request for input to the 2006 report on investment disputes and expropriation claims.

13. (SBU) Post knows of three claims by United States citizens outstanding against the Government of Kazakhstan (GOK). The claimants are identified at the end of this cable. One of the three cases (Case 2 / Claimant B) has been resolved.

Case 1

a. Claimant A

b. 1996

c. In the summer of 1996, when the Kazakhstani government sold Claimant A a large power station in northern Kazakhstan, the government agreed that its state power company, Kazakhstanenergo, would pay a specified amount for power deliveries. However, Kazakhstanenergo fell far behind in making payments, and as of June 1998, Claimant A calculated its arrears at approximately \$150 million. Claimant A offered the government a wide range of remedies to cover its debt. Claimant A also filed for international arbitration as provided for in its contract. Ahead of an expected June 23, 1999, arbitration decision in London, the GOK and Claimant A signed a memorandum of understanding (MOU) calling for a negotiated solution, and subsequently negotiated a second MOU on how the dispute would be resolved.

At first, the GOK made progress in fulfilling its obligations, completing four of six contracts called for by the settlement, under which debt was swapped for management rights in the electricity distribution business in Eastern Kazakhstan. The GOK's performance under the other two contracts, however, continues to be an issue.

One of the two problematic contracts, signed by Claimant A and the Ministry of Energy, provided for preferential deliveries of power (at 10% discount off the standard rate) to Russia on the Omsk line. In fall 2005, KEGOC, a state-owned power transmission company and a co-party to the contract, refused to deliver electricity on the line. In response, Claimant A has

commenced an arbitration action with the London Court of International Arbitration (LCIA). The GOK has tried to resolve the issue in a local court in Pavlodar. The Pavlodar court has refused to hear the case. At issue for Claimant A is the principle of contract sanctity - the notion that KEGOC cannot stop power transmission at will. Notably, the Ministry of Energy is supportive of the claimant and encouraging KEGOC to settle.

The second source of contention is the contract for completion of power and hydroelectric plants. Negotiations continued until summer of 2002, and then broke down. In December 2002, the GOK attempted to invalidate the underlying contract in Kazakhstani court, but the court dismissed the suit, since the contract provided solely for international arbitration with the LCIA to resolve disputes. The GOK refused to submit to arbitration, and in April 2003, initiated a new suit in Kazakhstani court, this time seeking to revoke only the arbitration clause of the contract. According to the claimant, the GOK stated to the court that it was "not aware of such an institution" in reference to the LCIA, London. In January 2004, the Kazakhstani Supreme Court ruled that the international arbitration clause, as written, was invalid (the written summary of the decision states that a re-worded clause might be acceptable.)

At the moment, a key issue for Claimant A is what it views as "creeping expropriation" by the GOK through the royalty mechanism. Claimant A is charged royalties by the Finance Ministry's State Property Committee for concessions - specifically, for the right to use (for 20 years up to 2017) two hydro-electric plants on the Irtysh River in Eastern Kazakhstan. The Committee, however, is charging the claimant a rate 50% higher than what the claimant sees as warranted by the contract. The Committee refuses to provide the claimant with an explanation of its calculation method.

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Recently, the Financial Police, which operates under the umbrella of the Finance Ministry, initiated criminal prosecution against the two plants' accountants and general directors. The charges currently focus on four to six people, all of them Kazakhstani nationals. Claimant A, however, has expressed the concern that prosecution could spread to include U.S. citizens. Claimant A sees the criminal prosecution as a way to force settlement. Claimant A, however, reports that it is close to reaching a settlement with the Ministry of Finance on the substantive issues.

The Embassy's support of Claimant A in its difficulties with the Kazakhstani government began in 1999 and continues to this day, as Claimant A is continuously subjected to various types of harassment. In July of 2005, two of its local employees were convicted of accounting improprieties in a trial that even the presiding judge admitted was dubious. Both avoided prison terms by benefiting from a pardon under the Presidential Amnesty Act. One of the two convictions has subsequently been overturned; the other, with an identical set of facts, is on appeal.

In a separate dispute, Claimant A purchased a bankrupt coal mine in 2001 to ensure fuel supplies for its primary generation facilities, spending over \$30 million to discharge debts and improve facilities. From the same year, Kazakhstani parties claiming to be owners of the mine filed a series of actions in regional courts. In many cases, neither Claimant A nor its counsel were advised of hearings or proceedings until days, or even hours, before they were to take place, making it extremely difficult to make travel arrangements to attend such proceedings. In October 2003, the Pavlodar Oblast court ruled that a Kazakhstani company was rightful owner of the mine, and thus entitled to dispose of its assets and require Claimant A to vacate the site. At Claimant A's request the Secretary of Commerce raised the dispute with President Nazarbayev. Subsequently, a higher court reversed the Pavlodar Oblast court's decision, and reestablished Claimant A's ownership of the mine.

However, in June 2005, armed agents of the Kazakhstani tax authorities raided Claimant A's offices at the Maikuben mine. They ejected Claimant A's employees from the building, took over the telephone switchboard and computer server room and demanded documents. This raid was ostensibly done in connection with an ongoing tax enforcement case, although the agents were seeking documents from a time period outside the scope of the inquiry.

Claimant A reports that, based on the documents forcibly seized from it in the June 2005 raid, it is being pressured by a regional environmental protection agency to pay an unofficial fine.

Case 2

a. Claimant B

b. 2000

c. In December 1998, Claimant B approved an \$18 million investment in a 75-unit residential compound in Almaty. The claimant invested in a joint venture with a local real estate development firm and lawfully acquired the land needed for the compound. In February 2000, the GOK announced a plan to establish a national arboretum on land that overlapped the boundaries of the claimant's. In July 2000, the claimant requested that the GOK convene a special working group to settle the dispute, as provided for by the law. The GOK continued to assert its right to take the claimant's land and started construction of the arboretum in February 2001. Subsequently, the police prevented the claimant's workers from entering the claimant's entire plot of land. The GOK failed to offer the claimant satisfactory compensation for the taking.

In 2002, the case went to arbitration at the International Court for the Settlement of Investment Disputes (ICSID). In October 2003, ICSID found for the claimant and awarded damages in excess of \$10 million.

Post actively supported Claimant B. The Ambassador and senior officials of the State and Commerce Departments frequently and forcefully reminded the highest GOK officials of Kazakhstan's

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obligation under the U.S.-Kazakhstan Bilateral Investment Treaty to honor the arbitral award and warned of negative consequences for Kazakhstan's investment and debt ratings if the GOK failed to pay.

Following extensive USG encouragement, the GOK reached a settlement with Claimant B consistent with the arbitration decision and made a requisite payment in late April 2006.

Case 3

a. Claimant C

b. 2001

c. In July 2001, the Kazakhstan Ministry of State Revenue (MSR) performed an audit and assessed a \$29 million tax claim on claimant, a subsidiary of a U.S. parent company. The assessment was based on MSR's finding that \$100 million received by claimant from a customer (the operating consortium of the offshore Kashagan oil field), as reimbursement for capital expenditures incurred by claimant in modifying a barge rig, was taxable income. Claimant C challenged the decision in Astana City Court, which ruled in the claimant's favor, holding that the reimbursements were not, in fact, taxable income. Following an appeal by the MSR, Kazakhstan's Supreme Court ruled in favor of claimant in March 2002.

The Kazakhstani tax authorities have persisted in appealing the case in subsequent years, bringing the case to the Supreme Court a total of four times. In May 2006, the Supreme Court ruled in favor of the Kazakhstani tax authorities. Claimant subsequently contacted the USG, though to date has not requested or recommended any specific Embassy intervention. By early June the claimant's attorneys had successfully filed a stay of the collection process triggered by the Supreme Court decision, and were planning an appeal.

14. For Department information only:

Claimant A: AES Silk Road Corporation

Claimant B: AIG Silk Road Capital Management

Claimant C: Parker Drilling Company
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